FITCH AFFIRMS SANTA CLARITA VALLEY WATER AGENCY, CA COPS AND REVS; OUTLOOK STABLE

Fitch Ratings-Austin-02 March 2018: Fitch Ratings has affirmed the following ratings of the Santa Clarita Valley Water Agency, CA (SCVWA or agency) formerly the Castaic Lake Water Agency (CLWA):

--$67.1 million in outstanding senior lien revenue certificates of participation (COPs), series 1999A at 'AA';
--$17.5 million adjustable rate refunding revenue COPs, series 2008A at 'AA-';
--$51.5 million refunding revenue COPs, series 2010A at 'AA-';
--$8.8 million refunding revenue bonds, series 2014A at 'AA-';
--$59.4 million Upper Santa Clara Valley Joint Powers Authority revenue bonds, series 2015A at 'AA-';
--$54.5 million Upper Santa Clara Valley Joint Powers Authority revenue bonds, series 2016A at 'AA-'.

The Rating Outlook is Stable.

SECURITY

The obligations are payable from the net revenues of the agency's wholesale water system. Net revenues include facility capacity fees and the agency's share of the county's 1% ad valorem taxes but excluding property taxes levied for payment of State Water Project (SWP) obligations. The series 2015A and 2016A bonds are payable from revenues pursuant to an installment purchase agreement (IPA) between the Santa Clara Valley JPA and the agency. The agency's payments under the IPA are absolute and unconditional and are on parity with the agency's own outstanding COPs and bonds payable subordinate to the agency's senior lien debt (series 1999). The senior lien is closed.

The agency owns three of the four retail water purveyors to which it sells water. However, the revenues from the retail operations are not pledged to bondholders and have separately secured debt outstanding.

KEY RATING DRIVERS

SOUND FINANCIAL PERFORMANCE: Debt service coverage (DSC) is solid and liquidity is robust. The agency's rate structure, which includes a large fixed rate component, mitigated revenue losses associated with deep drought-related declines in water demand in fiscal years 2015 and 2016.

DIVERSE AND STABLE REVENUE BASE: The agency's pledged revenue stream is diverse, consisting primarily of wholesale water revenues, a portion of the county's 1% property tax, and facility capacity fees. Property tax receipts and facility capacity fees grew moderately over the last five fiscal years with a healthy pace of new development.

MODERATE DEBT; MANAGEABLE CAPITAL: Debt levels are elevated, but are projected to remain stable despite planned debt issuance for capital needs, due to above-average amortization of existing debt.

WATER SUPPLIES SUFFICIENT: Water supplies are sufficient to meet demands in the near and long term. The agency has ample water reserves in storage to buffer the impacts of California's weather related supply volatility.

ESSENTIAL SERVICE: The agency serves an essential purpose within a wealthy and diverse service area that benefits from its proximity to the Los Angeles metro. The four retail water systems are highly reliant on the agency and have limited access to other water supplies.

RATING SENSITIVITIES

CONTINUED HEALTHY FINANCIAL METRICS: Maintenance of strong financial results coupled with declining debt levels could lead to an improvement in credit quality over time.

PRESSURE FROM SUPPLY RESTRICTIONS: Recurring droughts could apply some pressure if financial margins or liquidity levels fall significantly below expectations due to severe, multi-year water rationing. However, Fitch believes that the agency's rate structure should insulate revenues from reduced water sales.

CREDIT PROFILE
Located predominantly in Los Angeles County, approximately 35 miles northwest of downtown Los Angeles, the agency provides supplemental wholesale water service to a population of approximately 273,000 through four retail purveyors. The agency provides around 50% of the region's water supplies (40,081 acre-feet [AF] in 2017) with the remainder derived from the four retail purveyors' own local groundwater sources. Although retail water purveyors are not contractually required to buy minimum amounts from the agency in any given year, alternate water supply options are limited and producing additional water sources would be very costly to the retailers.

In January 2018, CLWA and Newhall County Water District (NCWD) were merged to become Santa Clarita Valley Water Agency pursuant to Senate Bill 634. Pursuant to the terms of the merger, SCVWA succeeded to all the rights duties, obligations, contracts, responsibilities, assets, entitlements, and liabilities of CLWA and NCWD including all the outstanding indebtedness. The agency continues to operate as a wholesale water provider, but now has the former NCWD as a retail division, Newhall Water Division. In addition, pursuant to SB 634, the SCVWA dissolved the former Valencia Water Company (VWC), which was 100% owned by CLWA. The service area of the former VWC is now the Valencia Water Division under the succeeding SCVWA.

USING STORED WATER TO BUFFER DROUGHT IMPACTS
The agency's water supplies come mostly from Northern California's San Francisco Bay/ Sacramento-San Joaquin River Delta via the State Water Project (SWP) contract (expiration in 2038). SWP supplies have been significantly affected by the statewide drought in California in recent years but the agency has acquired other supplies and maintains sizable reserves of stored water.

The SWP contract provides the agency with rights to 95,200 AF but actual deliveries are often less than this amount. In addition to its SWP contract, the agency has made investments in other water supplies and storage agreements to buffer the highly variable nature of the SWP water allocation. The agency has four groundwater banking and exchange accounts in three separate programs and has accumulated approximately 100,000 AF of banked and exchanged water as of January 2018. This is more than two years' worth of the projected 2018 aggregate water demand from the agency by the four retail purveyors. The agency also maintains certain previously unused SWP water and other supplies stored in SWP surface reservoirs which are also available to meet retailer demands.

Given the frequency of droughts and uncertainty with regards to SWP allocations in any year, the agency's water bank mitigates water supply risk in the short to medium term. The agency has also begun adding recycled water to its supply source. Although currently a minimal amount (about 455 AF annually), the agency has a four-phase capital project to increase recycled water in the future.

DIVERSE AND STABLE REVENUE BASE
Financial operations of the agency's wholesale system are stable, facilitated by diverse revenue sources comprised of water charges, a portion of the county's 1% property tax levy, and facility capacity fees (connection fees). Additional revenues include settlement agreements and sale of water in excess of storage capacity to non-member purveyors. The agency also levies a property tax to pay its costs associated with the SWP, which while not pledged to bondholders, is included in Fitch's analysis.

The board adopted a new wholesale water rate structure effective on April 1, 2016 that is comprised of fixed and variable components to effectively recover 80% of the general fixed costs of the agency as well as those fixed costs directly related to water supply and delivery. The total fixed costs are allocated to the retail purveyors and an additional variable rate charge per acre foot, for treatment and distribution costs of imported water and 20% of agency fixed costs, is collected based on actual water deliveries. The retail water purveyors are billed monthly and are required to pay within a 30 day term to remain eligible for future water deliveries.

SOUND FINANCIAL METRICS
For fiscal 2017, Fitch-calculated all-in DSC from consolidated funds of the wholesale system was a solid 2.5x (or 2.0x excluding capacity fees). Water sales to the four retailers increased as a result of the lift on drought restrictions. While water volume sales jumped 72%, revenues rose by a more moderate 30%. The agency's rate structure, designed to recover fixed costs, is expected to mitigate the impact of the water sales volatility on its financial profile to ensure adequate DSC is maintained in times of sales decline. Liquidity is robust, with over $86 million, or 719 days of total operating expenditures in unrestricted cash and investments in fiscal 2017.

Management's projected operating results for fiscal years 2018 through 2022, which is based on pledged revenues and excludes SWP revenues and expenses, show all-in DSC to range between a low 1.5x to a high 1.8x (1.2x to 1.5x net of facility capacity fees). The agency calculated debt service coverage takes into account additional bond repayment sources that are also pledged to bondholders including settlement receipts, proceeds from grants and reimbursements, and now a scheduled annual loan repayment from Valencia Water Division. These projections assume relatively flat facility capacity fees and modest growth in the agency's share of the 1% property tax resulting from gradual improvement in area development.

SENIOR LIEN DEBT
The agency has one remaining series of senior lien bonds (series 1999) outstanding. These bonds were issued as capital appreciation bonds with no maturities until fiscal 2022. Although, the agency currently has no debt service associated with this senior lien, annual $10.4 million debt service payments will be due between fiscal years 2022-2031. The 'AA' rating on the closed senior lien bonds reflects their priority in the flow of funds and limited debt service requirements.

MODERATE DEBT PROFILE; MANAGEABLE CAPITAL PLAN
Debt levels are elevated, although amortization of existing debt is relatively rapid. The agency's five-year fiscal 2018 through 2022 capital improvement plan (CIP) totals approximately $162 million of which 68% is projected to be debt funded and the remainder with a combination of available reserves, pay-go and grants. The agency plans to return to market with approximately $57 million in aggregate in fiscal years 2019 and 2021. With the planned bond sales, debt levels are expected to increase modestly, but should remain manageable given the relatively rapid amortization rate.

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Applicable Criteria
Rating Criteria for Public-Sector, Revenue-Supported Debt (pub. 26 Feb 2018)
https://www.fitchratings.com/site/re/10020113
U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017)
https://www.fitchratings.com/site/re/898466
U.S. Water and Sewer Rating Criteria (pub. 30 Nov 2017)
https://www.fitchratings.com/site/re/10010508